1980 Annual Report

WARNACO

White Stag

Warner's

Warnaco Men's Sportswear

Hathaway

CBS Apparel

Hirsch Weis

Warnaco International

Rosanna

Jerry Silverman

Financial Highlights

(Dollars in thousands except per share data)	1980	1979	% Change
Net Sales	**$465,009**	$448,345	+ 3.7
Income Before Extraordinary Credit	**16,590**	13,923	+ 19.2
Net Income	**16,590**	16,564	+ 0.2
Current Assets	**185,049**	182,712	+ 1.3
Current Liabilities	**68,763**	76,120	− 9.7
Property, Plant & Equipment	**30,306**	26,899	+ 12.7
Shareholders' Equity	**102,303**	88,838	+ 15.2
Primary Earnings Per Share:			
Before extraordinary credit	**3.87**	3.28	+ 18.0
Extraordinary credit	**—**	.64	−100.0
Net income	**3.87**	3.92	− 1.3
Fully Diluted Earnings Per Share:			
Before extraordinary credit	**3.42**	2.93	+ 16.7
Extraordinary credit	**—**	.54	−100.0
Net income	**3.42**	3.47	− 1.4
Book Value Per Share Of Common Stock	**24.06**	20.81	+ 15.6

Warnaco is a diversified apparel company whose business units market leading brands in apparel and leisure products. Products bearing directly owned labels include Warner's intimate apparel and daywear; Hathaway men's dress and sport shirts; Puritan men's sweaters and sport shirts; White Stag women's sportswear, as well as men's, women's and children's active sportswear, skiwear and outerwear; Edelweiss men's, women's and children's skiwear; Foxfire men's and women's insulated outerwear; Mountain Goat men's, women's and children's shirts, sweaters and outerwear; Rosanna women's sweaters and sportswear; The Sporting Life men's sport shirts; Thane men's sweaters and sport shirts; Hathaway women's shirts and blouses and Jerry Silverman women's dresses. Labels marketed under exclusive licenses include Christian Dior men's dress shirts, ties, sweaters, leathergoods and jewelry; Chaps by Ralph Lauren men's dress shirts, woven sport shirts, knit shirts, ties and ascots; Speedo swimsuits; Fruit of the Loom men's, women's and children's sportswear; Superstars juvenile and children's sportswear; Spalding men's and women's active sportswear; Jack Nicklaus sweaters and golf shirts and Yves Saint Laurent women's intimate apparel, daywear and sleepwear.

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Philip J. Lamoureux, President, at lower right, meeting with several division presidents to discuss budgets and marketing strategy.

To the Shareholders

The past year was the best in Warnaco's history, with new record levels attained in sales and profits, demonstrating the basic strength of our brand names in a difficult recessionary period.

Pre-tax profits rose 15 percent over 1979 to $24,608,000. Net operating income after tax increased 19 percent to $16,590,000 or $3.42 per fully diluted share, up from $13,923,000 or $2.93 per share in 1979. In 1979 the company had an extraordinary tax carryforward credit of $2,641,000 and in spite of this addition to income last year, 1980 net profits exceeded 1979.

Revenues increased to $465,009,000 notwithstanding the sale of the assets of the Camping and Watersports operations of Hirsch Weis and the liquidation of the High Tide swimsuit division during the year. These operations were terminated because it was felt that the company's investment in this sector could be more profitably used in other areas of our business.

Market conditions throughout the world continued unstable, but both domestic and international operations performed most satisfactorily. Domestically, Warnaco's major brands moved strongly ahead with Hathaway, Puritan, Warner's and White Stag in the van. Products marketed under the Christian Dior label — men's dress shirts, neckwear, sweaters, small leather goods and men's jewelry — enjoyed outstanding growth. Knit shirts and sweaters, endorsed by Jack Nicklaus and marketed by the Hathaway and Puritan divisions, continued their superior growth rate.

CBS Imports had a difficult year. The impact of high interest rates on the high volume, low margin environment in which this division operates was substantial and significant restructuring was begun in 1980 to address these challenges.

The International Division recorded another good year highlighted by an exceptional performance in the Warner's Mexican operation.

In addition to the operating gains recorded during the year, an examination of our year-end balance sheet reveals that Warnaco again demonstrated its financial strength and stability. Total assets employed increased to $228 million, shareholders' equity grew by over $13 million to $102 million ($24.06 per common share), and working capital increased to $116 million compared to $107 million last year. During this period of unprecedented high short-term interest rates we were able to reduce our average short-term borrowing from last year's levels. The Revolving Credit Agreement entered into last year should continue to provide adequate borrowing capacity until its expiration in 1982.

Your Board of Directors increased the quarterly dividend to shareholders of the common stock to 20 cents from 15 cents per share in the first quarter of 1980 and it was again increased to 25 cents in February of 1981.

The company's growth over the past four years has generated the need for greater productive and distribution capacities. During 1980 two such new facilities and a facility renovation were financed with industrial development bonds at interest rates between 6.75 percent and 8.0 percent.

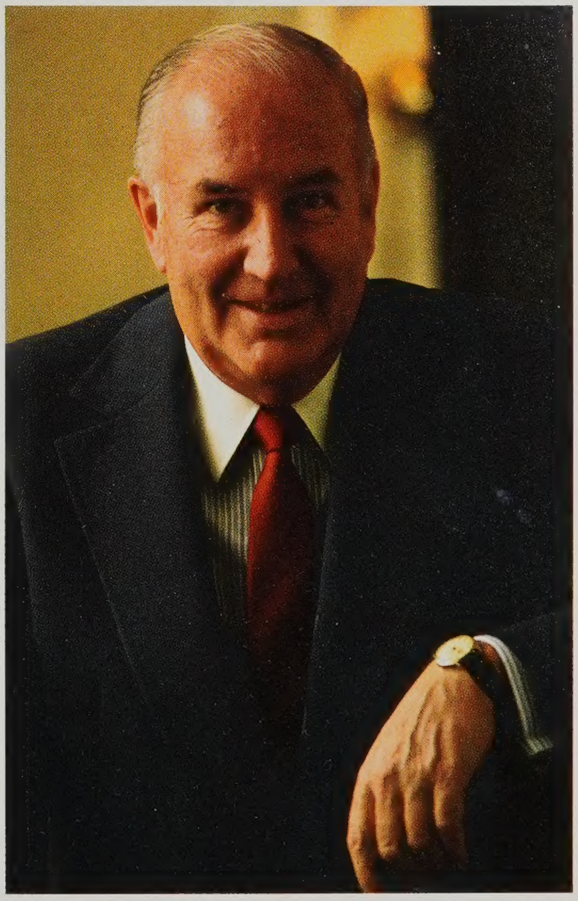
John F. Moriarty, Jr., Vice President—Market Relations of Warnaco and a Director, retired in June and left the Board after 41 years of service with the company. Mr. Moriarty spent 27 years with the Warner's Division, rising to its presidency, before joining the Corporate staff in an executive capacity.

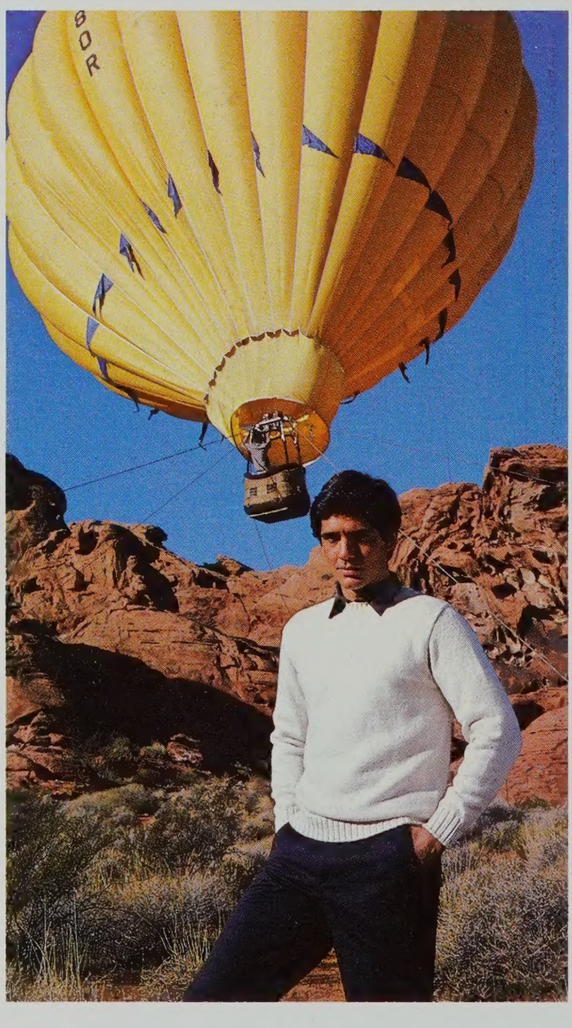
The outlook for the coming year is uncertain in view of world economic conditions. However, initial advance orders for 1981 are ahead of last year, and the pace of incoming orders continues to reflect this trend. Assuming a reasonable level of retail activity for the balance of the year, we would expect our major brands to continue to increase their market shares and to benefit from the heavy retail concentration on strong apparel brands.

Warnaco's progress in 1980 did not come easily. Great credit is due our employees for an outstanding effort. The aggressive manner in which our customers promoted our brands and merchandise also deserves our grateful acknowledgement. In addition, we thank our suppliers and shareholders for their solid support.

James C. Walker
Chairman and
Chief Executive Officer

March, 1981
Bridgeport, Connecticut

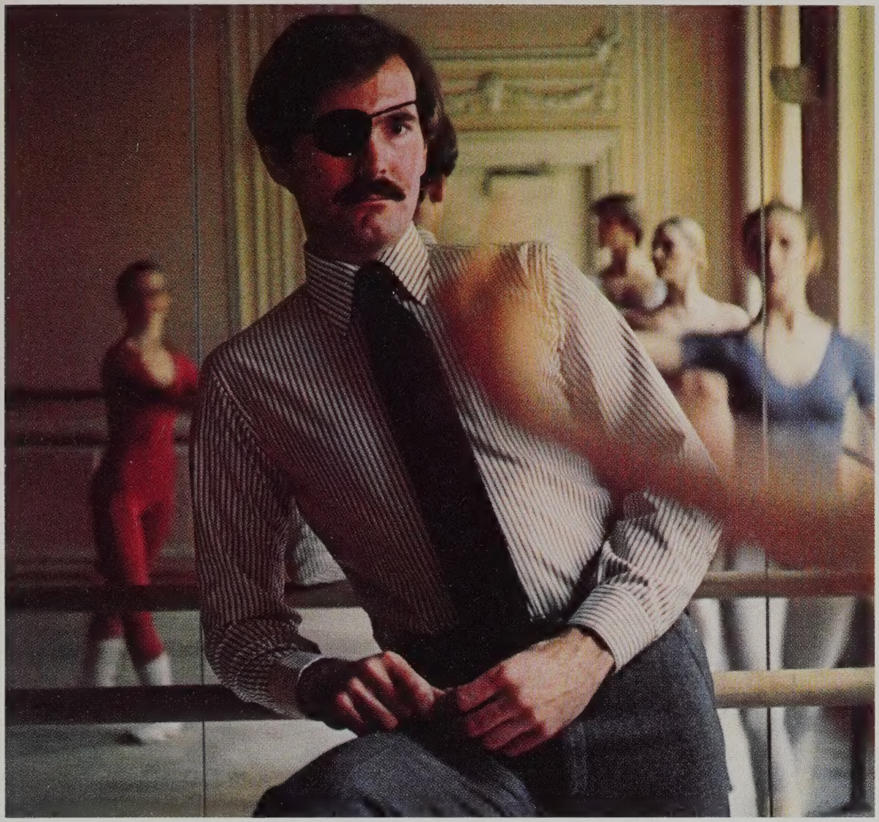




The Warnaco Knitwear Division exceeded its ambitious sales and earnings goals in 1980. The Puritan brand was the front-runner of the division with unique and competitive product development. The division recently began marketing Christian Dior sweaters and noted gratifying acceptance from both retailers and consumers. It is expected that these two brands, by accelerating their penetration of the market, will make meaningful contributions to future division earnings.

Thane continues to enjoy its premium position in men's sweaters and knit shirts. Its ability to create discernible differences in higher quality products will enable it to accelerate its growth in a favorable knit market.

Rosanna, the women's sweater brand, was in the midst of a trading up program and did not contribute to earnings. However, with its new product lines and a favorable consumer and retailer image, Rosanna should once again enter a growth period.



The Hathaway Division tallied its fifth consecutive year of dramatic increases in sales and pretax profit.

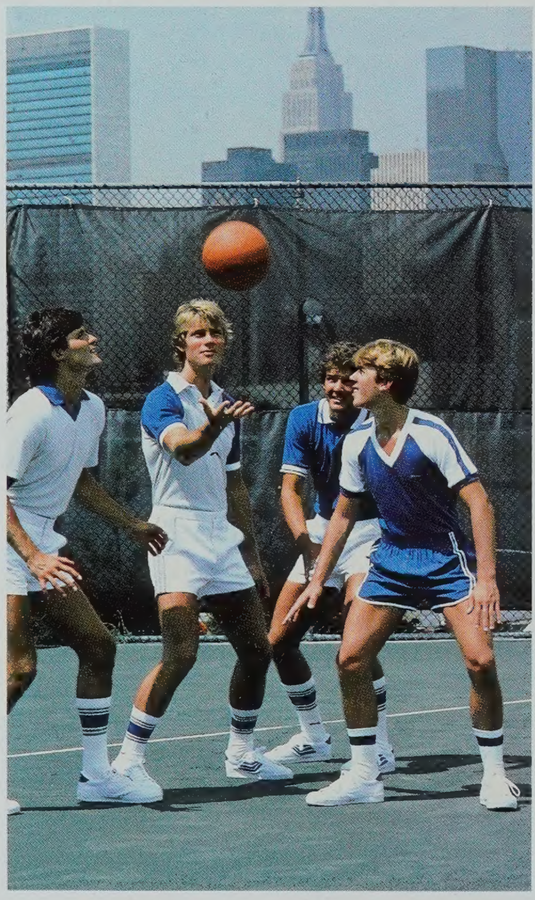
The division markets three brands of men's furnishings that are directed at special segments of the higher quality market: Hathaway, the most prestigious classic brand; Christian Dior for the fashionably elegant, and Chaps by Ralph Lauren for the young traditionalist. Hathaway will continue to sell only through the premier stores of America.

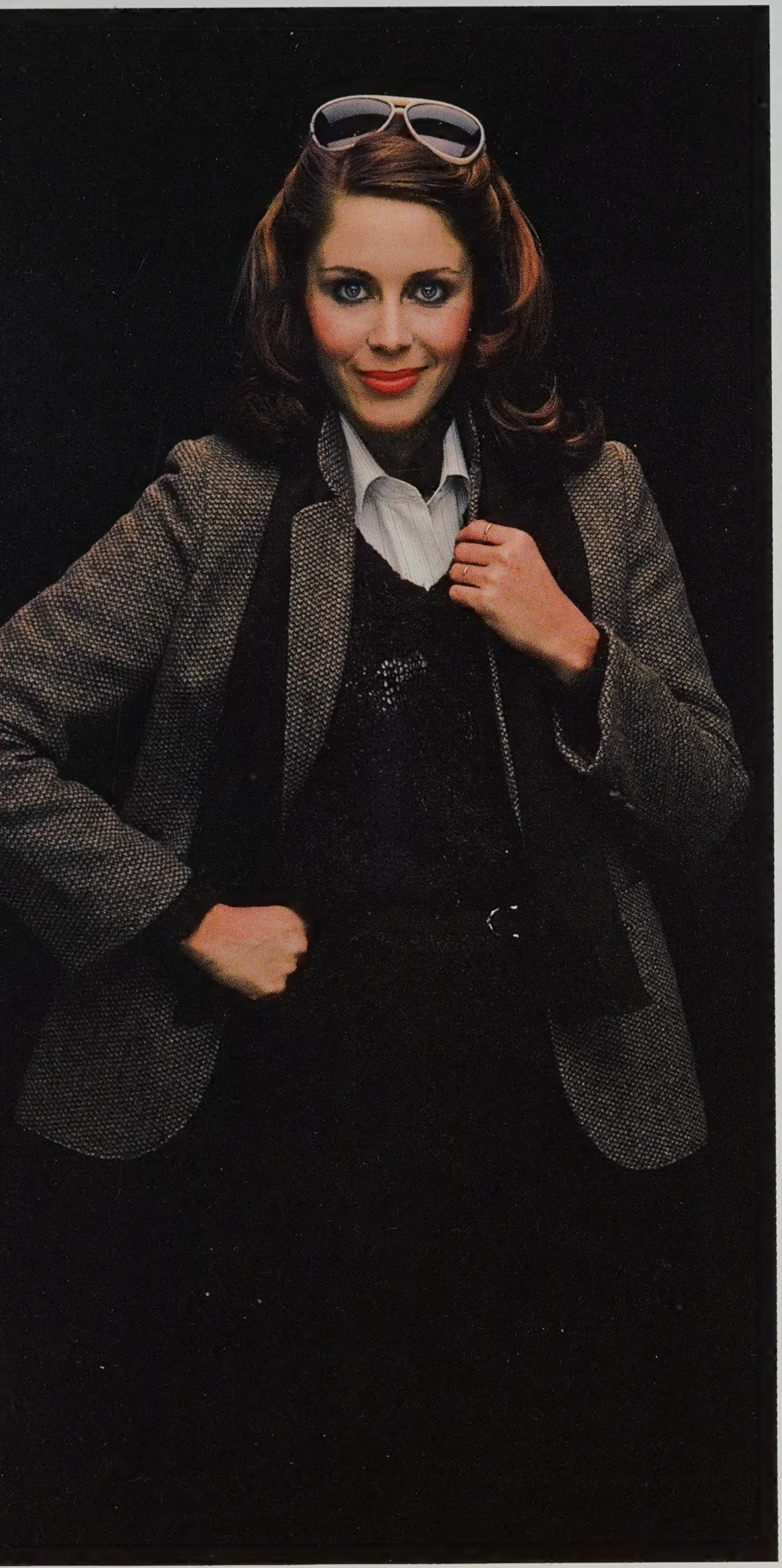
The division has recently added a new distribution center in Waterville, Maine, to accommodate current and future growth. The strength of Hathaway's management team and its business plan affirms our belief that the division will continue its exceptional and profitable growth.

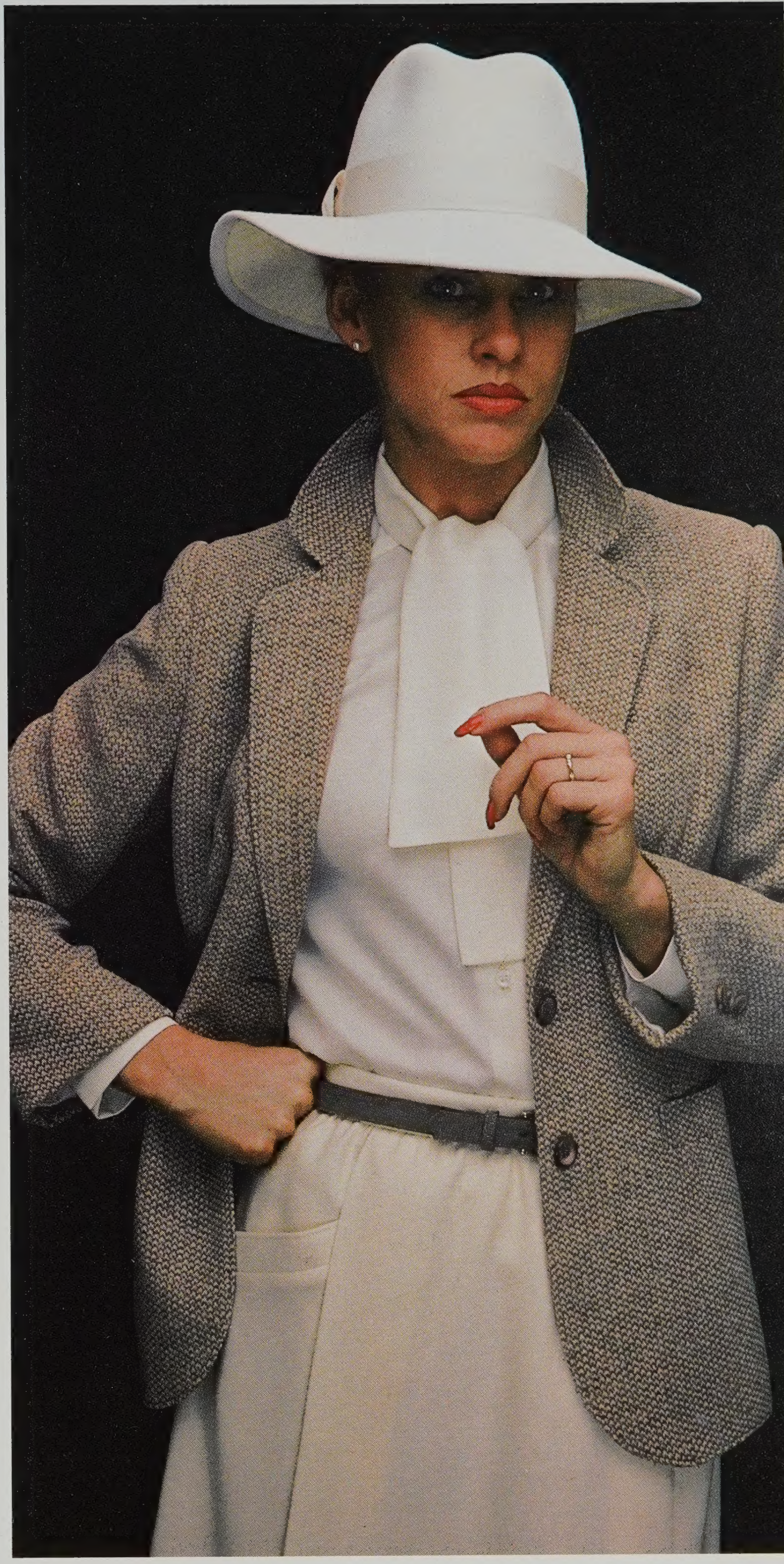
1980 marked another record year in sales and profits for White Stag, America's leading producer of action wear. The exceptional growth of the division's misses sportswear and outerwear volume continued at an accelerated pace. The year also marked the introduction of two new product lines by the ActionSports unit: Stag menswear and Snowlark skiwear.

White Stag's Sportswear unit markets coordinated separates for each season of the year, including misses pants, skirts, shorts, blazers, blouses, tee shirts, shirts and sweaters. The White Stag outerwear line includes both coats and jackets.

The division's ActionSports unit produces America's foremost skiwear label, White Stag, as well as Mountain Goat, Expertise and Snowlark skiwear, White Stag warmup suits and shell jackets, and Stag men's sportswear and outerwear.







Warner's, in 1980, marked its 105th year of successful marketing of intimate apparel products to the country's leading department and specialty stores. It was also another year of profitable growth and significant achievements for the division in a period of difficult economic conditions.

Following seven years of sales and earnings growth, all Warner's product lines contributed to record profits. Warner's brand slimwear continued to increase bra and girdle sales by keying its efforts to innovative products designed to fulfill the specific needs of consumers in all market segments—contemporary, traditional or full figure. Also contributing to increased sales were strong consumer marketing programs designed to assist retailers in promoting the Warner's brand, and expertise in selling and marketing by a highly effective sales and service organization.

Warner's brand daywear lingerie, in its second full year of operation, achieved outstanding results in both sales volume and market penetration by applying similar merchandising, marketing and selling techniques as Warner's brand slimwear.

Exclusive Apparel, the private label unit marketing intimate apparel to the country's leading chain store outlets, continued to maintain its leadership position.

Warner's strategy for 1981 and beyond is an aggressive program for increased growth within established product lines and the addition of new ones where growth potential exists. In line with this strategy, Warner's has concluded a licensing agreement with the prestigious designer, Yves Saint Laurent, to manufacture and market intimate apparel under the Yves Saint Laurent label.

The International marketplace offers numerous opportunities to Warnaco in its well known brands. Internationally, the company's varied quality brand merchandise is offered through a combination of wholly-owned subsidiaries, joint ventures, licensing agreements and exports. These diversified lines of International distribution provided a strong contribution to Warnaco's income again in 1980. Flat results in recession area economies were more than offset by exciting increases in growth markets.

Canada represents the largest part of Warnaco's international business, followed closely by Europe. The Mexican operation is expanding at an explosive rate created by the rapid growth of the Mexican economy.

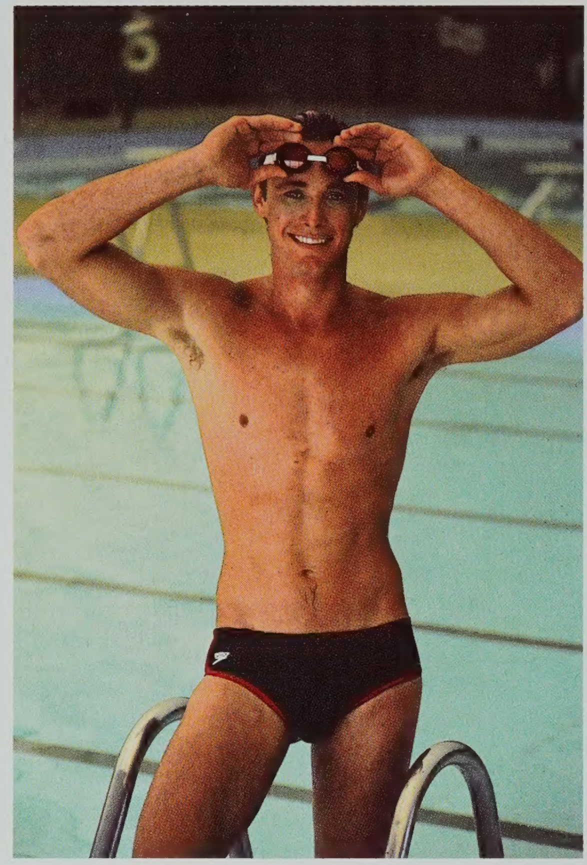
The International marketplace continues to offer significant future potential. International market development strategies are focusing on those Warnaco brands which will provide the greatest profit-growth for the future.

Major internal changes were made by Hirsch Weis during 1980. The Camping and Watersports divisions were sold in the late summer; the distribution center was relocated from Portland, Oregon to the White Stag distribution facility in Murfreesboro, Tennessee, and the Hirsch Weis administrative offices were relocated in Portland.

With the sale of the Camping and Watersports divisions, Hirsch Weis will devote its full attention to the competitive and active swim and sportswear potential of the Speedo brand for which Hirsch Weis is the U.S. distributor.

While concentrating on strengthening its majority share of racing swimwear business, Hirsch Weis is also introducing a men's and women's active swimwear line. Although the independent sporting goods stores continue to be the foundation of Hirsch Weis' distribution, a successful and controlled entry into department stores was made in 1980.

Swimming continues to be America's most popular participation sport and Hirsch Weis/Speedo is vigorously seeking a bigger share of that huge potential market.



The CBS Imports Division markets men's and boys' shirts, sportswear and jeans to the finer quality mass merchandisers. It was not a good year for CBS Imports owing to economic conditions within the retailing segment it serves. The problems were compounded by high interest and warehousing costs of carrying inventories most of the year.

Inventories have been reduced dramatically and the outlook has improved. Despite these conditions, CBS successfully launched a high quality active sportswear line under license from Spalding. This line and the Fruit of the Loom products currently marketed by CBS will be the key to the future success of the division.

Quarterly Financial Data (Unaudited)

(Dollars in thousands except per share data)	1980 Quarters					1979 Quarters				
	1st	2nd	3rd	4th	Year	1st	2nd	3rd.	4th	Year
Net sales	$108,401	$95,167	$140,222	$121,219	$465,009	$101,831	$95,017	$133,629	$117,868	$448,345
Gross profit	33,655	28,078	45,287	38,984	146,004	29,418	27,574	41,331	34,232	132,555
Income before extraordinary credit	2,445	250	8,217	5,678	16,590	1,929	1,159	6,559	4,276	13,923
Extraordinary credit (loss)	—	—	—	—	—	713	(22)	1,950	—	2,641
Net income	2,445	250	8,217	5,678	16,590	2,642	1,137	8,509	4,276	16,564
Per share data										
Primary:										
Before extraordinary credit	$.56	$.04	$1.96	$1.31	$3.87	$.44	$.26	$1.56	$1.02	$3.28
Net income	.56	.04	1.96	1.31	3.87	.62	.25	2.03	1.02	3.92
Fully diluted:										
Before extraordinary credit	.51	.04	1.69	1.18	3.42	.41	.26	1.36	.90	2.93
Net income	.51	.04	1.69	1.18	3.42	.56	.25	1.76	.90	3.47
Cash Dividends Paid per Share										
Common stock	.20	.20	.20	.20	.80	—	.10	.10	.15	.35
$1.50 Cum. Cv. Pfd.	.37½	.37½	.37½	.37½	1.50	.37½	.37½	.37½	.37½	1.50
$1.10 Sub. Cum. Cv. Pfd. Ser. A	.27½	.27½	.27½	.27½	1.10	.27½	.27½	.27½	.27½	1.10
$3.00 Non. Cum. Pfd.	—	—	—	3.00	3.00	—	—	—	3.00	3.00
High/Low Prices on NYSE										
Common Stock	17¾	16⅝	16⅜	16¾	17¾	11¼	11⅛	13	11¾	13
	10⅛	13⅛	13½	14½	10⅛	9	8¾	8¾	9⅜	8¾
$1.50 Cum. Cv. Pfd.	29	29	29	29⅛	29⅛	28	26	28⅛	28⅛	28⅛
	26½	29	29	28	26½	25¾	24⅛	26	26½	24⅛

Summarized quarterly financial data for 1980 and 1979 are presented above.

The subordinated cumulative convertible preferred stock, Series A, is not listed on any exchange.

TRADEMARKS

Trademarks owned by Warnaco, its subsidiaries or affiliates include: Warner's, Hathaway, Hathaway Golf Classic, White Stag, leaping stag design, Stag & design, Mountain Goat, Expertise, Edelweiss, Puritan, Rosanna, Foxfire, Jerry Silverman, Hirsch Weis, Speedo, Thane, The Sporting Life, CanaDay's and Croydon.

Statements of Consolidated Income and Retained Income

Income Year Ended	**January 3, 1981 53 weeks**	December 29, 1979 52 weeks	December 30, 1978 52 weeks
Net sales	**$465,009,000**	$448,345,000	$398,462,000
Costs and expenses:			
Cost of goods sold	**319,005,000**	315,790,000	281,293,000
Selling, administrative and general expenses	**102,855,000**	92,719,000	86,619,000
Interest expense	**14,474,000**	14,579,000	9,304,000
Employees' retirement plans (Note 3)	**3,732,000**	3,545,000	3,307,000
	440,066,000	426,633,000	380,523,000
Income before provision for loss contingencies, income taxes, minority interest and extraordinary credit	**24,943,000**	21,712,000	17,939,000
Provision for sale or liquidation of certain facilities (Note 2)	**—**	—	1,050,000
Operating income before income taxes, minority interest and extraordinary credit	**24,943,000**	21,712,000	16,889,000
Provision for income taxes (Note 4)	**8,018,000**	7,457,000	7,731,000
Minority interest in earnings of consolidated subsidiaries	**335,000**	332,000	501,000
Income before extraordinary credit	**16,590,000**	13,923,000	8,657,000
Extraordinary credit-tax effect of carry forward of prior years' operating losses and credits (Note 4)	**—**	2,641,000	4,514,000
Net Income for year	**$ 16,590,000**	$ 16,564,000	$ 13,171,000
Income per common share and common equivalent share (Note 5):—			
Primary:			
Before extraordinary credit	**$ 3.87**	$ 3.28	$ 2.00
Extraordinary credit	**—**	.64	1.09
Net income	**$ 3.87**	$ 3.92	$ 3.09
Fully diluted:			
Before extraordinary credit	**$ 3.42**	$ 2.93	$ 1.83
Extraordinary credit	**—**	.54	.93
Net income	**$ 3.42**	$ 3.47	$ 2.76
Retained Income			
At beginning of year	**$ 66,539,000**	$ 54,006,000	$ 41,842,000
Net income for year	**16,590,000**	16,564,000	13,171,000
	83,129,000	70,570,000	55,013,000
Cash dividends declared:—			
Preferred:			
$3 noncumulative ($3.00 per share in 1980, 1979 and 1978)	**5,000**	5,000	5,000
$1.50 cumulative convertible ($1.50 per share in 1980 and 1979 and $1.87½ in 1978)	**161,000**	190,000	268,000
$1.10 cumulative convertible ($1.10 per share in 1980 and 1979 and $2.20 in 1978)	**357,000**	366,000	734,000
	523,000	561,000	1,007,000
Common ($.80 per share in 1980 and $.35 in 1979)	**3,142,000**	1,365,000	—
	3,665,000	1,926,000	1,007,000
5% Stock dividend declared on common stock	**—**	2,105,000	—
	3,665,000	4,031,000	1,007,000
At end of year (Note 8)	**$ 79,464,000**	$ 66,539,000	$ 54,006,000

These statements should be read in conjunction with the accompanying Notes to Consolidated Financial Statements.

Consolidated Balance Sheets

Assets

Current Assets:	January 3, 1981	December 29, 1979
Cash, including time deposits of None—1980 and $280,000—1979 (Note 6)	$ 7,095,000	$ 6,427,000
Accounts receivable, less allowance for doubtful accounts of $2,895,000—1980 and $2,302,000—1979	72,302,000	67,063,000
Tax refunds receivable	181,000	1,330,000
Inventories, at the lower of cost or market (Note 7)	100,789,000	102,917,000
Prepaid expenses	4,682,000	4,975,000
Total current assets	185,049,000	182,712,000

Property, Plant and Equipment, at cost:		
Land and land improvements	1,832,000	1,904,000
Buildings and building improvements	30,049,000	25,800,000
Machinery and equipment	34,363,000	33,372,000
	66,244,000	61,076,000
Less-Accumulated depreciation	35,938,000	34,177,000
	30,306,000	26,899,000

Other Assets:		
Other investments and deferred charges	6,912,000	4,730,000
Excess of investment over net assets acquired, less accumulated amortization of $2,894,000—1980 and $2,481,000—1979	5,883,000	6,390,000
	12,795,000	11,120,000
	$228,150,000	$220,731,000

Liabilities and Shareholders' Equity

Current Liabilities:	**January 3, 1981**	December 29, 1979
Notes payable (Note 8)	**$ 16,773,000**	$ 27,122,000
Current portion of long-term debt	**4,221,000**	3,951,000
Accounts payable	**16,843,000**	16,133,000
Employees' retirement plans (Note 3)	**1,814,000**	2,004,000
Dividends payable	**38,000**	765,000
Accrued salaries and wages	**6,767,000**	6,577,000
Accrued liabilities	**13,325,000**	14,189,000
Foreign and other income taxes	**8,982,000**	5,379,000
Total current liabilities	**68,763,000**	76,120,000
Long-Term Debt (Note 8)	**43,487,000**	41,937,000
Deferred Incentive Compensation	**3,921,000**	2,957,000
Minority Interest	**4,876,000**	5,589,000
Redeemable Preferred Stock (Note 9)		
$1.50 cumulative convertible sinking fund, stated at $40 per share redemption value		
Shares authorized—120,080—1980 and 132,269—1979		
Shares issued 120,003—1980 and 132,247—1979	**4,800,000**	5,290,000
Liquidation value—$4,274,000—1980		
Non-Redeemable Preferred Stock (Note 10)		
$3.00 noncumulative, stated at $100 per share		
Shares authorized, issued and outstanding—1,550—1980 and 1979	**155,000**	155,000
Liquidation value—$155,000—1980		
$1.10 cumulative convertible subordinated Series A, stated at $3.75 per share		
Shares authorized—355,597—1980 and 1979		
Shares issued—309,378—1980 and 330,685—1979	**1,160,000**	1,240,000
Liquidation value—$7,734,000—1980		
Aggregate liquidation value of non-redeemable preferred stock $7,889,000—1980		
Common Stock (Note 10)		
Common stock, stated at $3.75 per share		
Shares authorized—7,500,000—1980 and 1979		
Shares issued—4,063,323—1980 and 4,026,167—1979	**15,237,000**	15,098,000
Other Shareholders' equity		
Capital in excess of stated value (Note 10)	**8,585,000**	8,391,000
Retained income	**79,464,000**	66,539,000
Less—Treasury stock at cost:		
Common shares—117,887—1980 and 1979	**1,927,000**	1,927,000
Preferred shares—13,155—1980 and 23,344—1979	**371,000**	658,000
	$228,150,000	$220,731,000

These statements should be read in conjunction with the accompanying Notes to Consolidated Financial Statements.

Statements of Changes in Consolidated Financial Position

Source of Funds / Year Ended	January 3, 1981 53 weeks	December 29, 1979 52 weeks	December 30, 1978 52 weeks
From operations:—			
Income before extraordinary credit	**$16,590,000**	$13,923,000	$ 8,657,000
Add (deduct) items not affecting working capital in the year:			
Depreciation and amortization	**4,699,000**	4,219,000	3,965,000
Deferred incentive compensation	**964,000**	563,000	468,000
Equity in undistributed earnings of affiliated companies	**(612,000)**	(752,000)	(277,000)
Working capital provided by operations	**21,641,000**	17,953,000	12,813,000
Extraordinary credit	**—**	2,641,000	4,514,000
Reduction of deferred charges, net	**184,000**	—	756,000
Increase in long-term debt	**4,997,000**	—	—
Miscellaneous	**301,000**	158,000	487,000
	27,123,000	20,752,000	18,570,000
Disposition of Funds			
Reduction of long-term debt	**4,450,000**	3,900,000	4,063,000
Additions to property, plant and equipment, less normal disposals	**7,693,000**	3,901,000	3,698,000
Reclassification to current liabilities of Reserve for Loss Contingencies	**—**	2,700,000	—
Dividends	**3,665,000**	1,926,000	1,007,000
Investment in stock of unconsolidated companies	**768,000**	—	100,000
Purchase of minority interest in CBS	**797,000**	—	—
Additions to deferred charges, net	**—**	375,000	—
Acquisition and retirement of Warnaco stock	**56,000**	768,000	236,000
	17,429,000	13,570,000	9,104,000
Increase in working capital	**$ 9,694,000**	$ 7,182,000	$ 9,466,000
Analysis of working capital change:—			
Increase (decrease) in current assets:			
Cash and time deposits	**$ 668,000**	$ (5,198,000)	$ 4,757,000
Accounts receivable	**5,239,000**	5,825,000	2,596,000
Tax refunds receivable	**(1,149,000)**	9,000	(300,000)
Inventories	**(2,128,000)**	7,357,000	13,339,000
Prepaid expenses	**(293,000)**	(967,000)	2,755,000
	2,337,000	7,026,000	23,147,000
Increase (decrease) in current liabilities:			
Notes payable	**(10,349,000)**	1,019,000	9,546,000
Current portion of long-term debt	**270,000**	21,000	(53,000)
Accounts payable and accrued liabilities	**554,000**	(1,865,000)	5,019,000
Employees' retirement plans	**(190,000)**	(976,000)	79,000
Dividends payable	**(727,000)**	727,000	(2,000)
Reserve for sale or liquidation of certain facilities	**(518,000)**	(1,126,000)	(1,116,000)
Foreign and other income taxes	**3,603,000**	2,044,000	208,000
	(7,357,000)	(156,000)	13,681,000
Increase in working capital	**$ 9,694,000**	$ 7,182,000	$ 9,466,000

These statements should be read in conjunction with the accompanying Notes to Consolidated Financial Statements.

Summary of Accounting Policies

Basis of Consolidation: The accompanying consolidated financial statements comprise the accounts of the parent company and all subsidiary companies. Investments in certain companies representing between 20 per cent and 50 per cent ownership are accounted for by use of equity accounting.

Translation of Foreign Currencies: Except for inventories, current assets and current liabilities are translated at the rate of exchange in effect at the close of the period. Non-current assets and inventories are translated at the rates in effect at the dates these assets were acquired, and long-term liabilities are translated at current rates. All gains and losses from foreign currency translation are taken into income as they occur. Revenue and expense accounts are translated at the average month-end exchange rates except for depreciation and amortization, which are translated at the rates of exchange which were in effect when the respective assets were acquired.

Inventories: Inventories are primarily stated at standard costs, which approximate actual acquisition and production costs.

Depreciation and Amortization: Provision is made for depreciation of property, plant and equipment computed over the estimated useful lives of the assets using the straight-line method for assets acquired prior to 1954, and generally using either straight-line or declining balance methods for assets acquired thereafter. The excess of investment over net assets of companies acquired, including those accounted for by use of equity accounting, is being amortized over not more than 40 years.

Income Taxes: United States income taxes are provided on the undistributed earnings of subsidiaries located outside the United States except in those cases where the earnings are expected to be permanently invested abroad. The investment tax credit is accounted for on the flow-through method.

Employees' Retirement Plans: The company has noncontributory pension and profit sharing retirement plans for the benefit of qualifying employees. Contributions are deposited with a trustee who administers the assets of the plans. The company accrues and funds current and prior service costs, which are being amortized over 30 years.

Minority Interest: The financial statements reflect a minority ownership of 30 per cent in Warnaco of Canada.

Capitalized Leases: The company capitalizes leases when it derives the benefits of ownership.

Notes to Consolidated Financial Statements

Note 1—Segment Reporting:

The company operates within one dominant industry segment—the manufacture of wearing apparel—and has no customer which accounts for ten per cent or more of its total sales. The company operates in several geographic areas which are analyzed below for the years ended January 3, 1981, December 29, 1979 and December 30, 1978:

Year 1980	**United States**	**Canada**	**Europe, Asia and Latin America**	**Consolidated**
Sales, substantially all to unaffiliated customers	**$389,605,000**	**$ 46,709,000**	**$ 28,695,000**	**$465,009,000**
Operating Profit	**$ 41,779,000**	**$ 2,911,000**	**$ 1,375,000**	**$ 46,065,000**
Equity in net income of Speedo Holdings Ltd. (26% interest)				**882,000**
Equity in net loss of Jorgen Skov (49% interest)				**(114,000)**
General corporate expenses				**(7,751,000)**
Interest expense				**(14,474,000)**
Income from operations before income taxes and after minority interest				**$ 24,608,000**
Identifiable assets at January 3, 1981	**$170,377,000**	**$ 25,167,000**	**$ 18,022,000**	**213,566,000**
Equity investments				**4,898,000**
Corporate Assets				**9,686,000**
Total assets at January 3, 1981				**$228,150,000**
Year 1979				
Sales, substantially all to unaffiliated customers	$373,328,000	$ 45,698,000	$ 29,319,000	$448,345,000
Operating Profit	$ 35,021,000	$ 3,573,000	$ 3,431,000	$ 42,025,000
Equity in net income of Speedo Holdings Ltd. (26% interest)				855,000
Equity in net loss of Jorgen Skov (49% interest)				(103,000)
General corporate expenses				(6,818,000)
Interest expense				(14,579,000)
Income from operations before income taxes and after minority interest				$ 21,380,000
Identifiable assets at December 29, 1979	$165,698,000	$ 26,146,000	$ 15,491,000	$207,335,000
Equity investments				3,741,000
Corporate Assets				9,655,000
Total assets at December 29, 1979				$220,731,000
Year 1978				
Sales, substantially all to unaffiliated customers	$334,772,000	$ 44,910,000	$ 18,780,000	$398,462,000
Operating Profit	$ 27,394,000	$ 2,370,000	$ 4,071,000	$ 33,835,000
Equity in net income of Speedo Holdings Ltd. (26% interest)				277,000
General corporate expenses				(7,370,000)
Interest expense				(9,304,000)
Provision for sale or liquidation of certain facilities				(1,050,000)
Income from operations before income taxes and after minority interest				$ 16,388,000
Identifiable assets at December 30, 1978	$161,504,000	$ 24,171,000	$ 13,156,000	$198,831,000
Equity investments				3,226,000
Corporate Assets				10,334,000
Total assets at December 30, 1978				$212,391,000

Operating profit is total revenue less operating expenses. In computing operating profit, none of the following items has been added or deducted: general corporate expenses, interest expense, income taxes, equity in income from unconsolidated investee, provision for sale or liquidation of certain facilities and the extraordinary credit from the tax effect of carry forward of prior year's operating losses.

Identifiable assets are those of the company that are identified with the operations in each geographic area. Corporate assets are principally cash and property, plant and equipment.

Net income of foreign subsidiaries, after amortization of the excess of investment over net assets acquired, was $2,207,000, $3,755,000 and $2,911,000 for the fiscal years 1980, 1979 and 1978, respectively. Dividends received from such subsidiaries were $1,023,000 in 1980, $2,343,000 in 1979 and $1,174,000 in 1978. The net assets of these subsidiaries were $22,765,000, $21,177,000 and $21,096,000 at January 3, 1981, December 29, 1979 and December 30, 1978 respectively. The translation of foreign currency resulted in a gain of $282,000 in 1980, $332,000 in 1979 and $218,000 in 1978.

Included in retained income at January 3, 1981, is $2,896,000 of undistributed earnings of 50% or less owned persons. Dividends received amounted to $276,000 in 1980 and $234,000 in 1979.

Note 2—Acquisitions and Dispositions:

During 1980 the company acquired the remaining 20% ownership of CBS Imports Corp. It also invested $768,000 in the purchase of 773,000 shares of Speedo Holdings Ltd. stock in order to maintain its equity share in this Australian apparel company.

During the year it disposed of its High Tide junior swimwear division through liquidation, and sold the assets of the camping and watersport operations of its Hirsch Weis Division. These transactions resulted in no significant gain or loss.

Also during 1980, the company completed the consolidation of certain warehouse and manufacturing facilities of its Knitwear Division. Since the total cost of the consolidation approximated the dispostion reserve established for this purpose in a prior year, there was no effect on income in 1980.

Note 3—Employees' Retirement Plans:

The company has several pension plans covering most of its domestic employees. Pension expense amounted to $3,732,000 in 1980, $3,545,000 in 1979 and $3,307,000 in 1978 which includes amounts for funding of prior service costs over a period of 30 years.

A comparison of estimated accumulated plan benefits and actual plan net assets for the company's U.S. defined benefit plans as of the end of the year is presented below:

	1980	1979
Actuarial present value of accumulated plan benefits:		
Vested	**$35,210,000**	$30,892,000
Nonvested	**2,300,000**	2,005,000
Total	**$37,510,000**	$32,897,000
Net assets available for benefits	**$32,046,000**	$27,944,000

The composite weighted average assumed rate of return used in determining the actuarial present value of accumulated plan benefits was 8.0% for the years 1980 and 1979.

Note 4—Income Taxes:

The following presents the U.S. and non-U.S. components of income before taxes excluding the unrealized foreign currency gains.

	1980	1979	1978
U.S. income before income taxes	**$13,979,000**	$13,778,000	$ 8,954,000
Non-U.S. income before income taxes	**10,682,000**	7,602,000	7,717,000
Foreign currency translation gain	**282,000**	332,000	218,000
Income before income taxes	**$24,943,000**	$21,712,000	$16,889,000

The provision for income taxes included in the Consolidated Statement of Income consists of the following:

	1980	1979	1978
Federal and state:			
Federal			
-currently payable	**$3,791,000**	$ 372,000	—
-deferred	**965,000**	1,408,000	—
-charge equivalent to federal income tax offset by loss and credit carry-forwards	—	2,641,000	$4,514,000
State			
-currently payable	**1,339,000**	400,000	306,000
	6,095,000	4,821,000	4,820,000
Foreign:			
Currently payable	**1,953,000**	2,823,000	2,744,000
(Prepaid) deferred	**(30,000)**	(187,000)	167,000
	1,923,000	2,636,000	2,911,000
Provision for income taxes	**$8,018,000**	$7,457,000	$7,731,000

Reconciliations of the differences between the average U.S. statutory tax rate and the consolidated effective book income tax rate are as follows:

	1980	1979	1978
Income from operations before income taxes, minority interests and extraordinary credit	**$24,943,000**	$21,712,000	$16,889,000
Tax at 46% 1980 and 1979, 48% 1978	**11,473,000**	9,987,000	8,107,000
Less tax benefit of Puerto Rico operations*	**(2,275,000)**	(142,000)	(800,000)
Taxable dividends from foreign subsidiaries eliminated in consolidation	**743,000**	2,259,000	368,000
Foreign tax at less than 48% and 46%	**(804,000)**	(1,505,000)	(325,000)
State income taxes	**723,000**	216,000	159,000
Foreign tax credits	**(796,000)**	(2,192,000)	—
Investment tax credits	**(400,000)**	(1,311,000)	—
Other—net	**(646,000)**	145,000	222,000
Provision for income taxes	**$ 8,018,000**	$ 7,457,000	$ 7,731,000

*The Tax exempt status in Puerto Rico terminates in 1993 and 1995.

Undistributed earnings of non-U.S. subsidiaries amounting to $19,217,000 at January 3, 1981 were considered by management to be permanent business requirements of the subsidiaries under present circumstances; consequently, no provision was made for the additional U.S. income taxes which might result if these undistributed earnings were remitted to the parent company. However, any decision to remit such earnings in the future in the form of dividends is not expected to result in significant additional income taxes.

Note 5—Income per Common Share and Common Equivalent Share:

The computation of average common shares and common equivalent shares (4,196,284—1980, 4,133,390—1979 and 4,147,089—1978) recognizes common shares which would be issuable upon conversion of the $1.50 preferred stock, and upon exercise of certain stock options. Fully diluted net income per share calculations further recognize the common shares which would be issuable upon the conversion of the convertible debt issued during 1971 and the related reduction of interest expense, assuming that conversion took place at the beginning of each year reported. The fully diluted net income per share calculations also recognize common shares issuable upon conversion of the convertible $1.10 Series A preferred stock and the related dividend reduction, assuming the conversion took place at the beginning of each year reported.

Note 6—Compensating Balances:

Under the $65,000,000 revolving credit agreement entered into August 21, 1979 that expires August 20, 1982, the company is required to maintain on deposit with the lending banks average compensating balances of 5 per cent of the total commitment and 15 per cent of the outstanding loan balances with these banks. Alternatively the company has an option to pay a fee, as defined, to each bank rather than maintain the required balances. In the opinion of management, the company has been in compliance with the compensating balance requirement for 1980.

At January 3, 1981 approximately $3,264,000 ($2,098,000—1979) of the cash balance shown in the Consolidated Balance Sheets represented compensating balances.

Note 7—Inventories:

Inventories are comprised as follows:

	January 3, 1981	December 29, 1979
Finished goods	**$ 62,399,000**	$ 66,027,000
Work in process	**16,887,000**	16,631,000
Raw materials	**21,503,000**	20,259,000
	$100,789,000	$102,917,000

Note 8—Debt:

Long-term debt (excluding installments maturing in less than a year), substantially all of which is owed to domestic lenders, consists of the following:

	January 3, 1981	December 29, 1979
5.5% notes payable, due 1981–1986	**$ 5,650,000**	$ 6,775,000
8.25% notes payable, due 1981–1989	**4,800,000**	5,400,000
Subordinated 9.375% notes payable, due 1981–1990	**13,375,000**	14,700,000
9.25% notes payable, due 1981–1988	**3,500,000**	4,000,000
Subordinated 7% convertible notes payable, due 1982–1991	**7,500,000**	7,500,000
6.5% mortgage payable, due 1981–1992	**1,112,000**	1,185,000
2.0%–6.3% capitalized lease obligations due 1981–1992	**1,747,000**	2,012,000
Development authority bonds 1981–1995 (interest 6.75%–8.0%)	**5,525,000**	—
Other (interest 2.0%–8.25%) due 1981–1988	**278,000**	365,000
	$43,487,000	$41,937,000

Approximate maturities of long-term debt are as follows: $4,844,000—1982; $4,798,000—1983; $4,730,000—1984; $4,705,000—1985.

In 1979 the company negotiated a revolving credit agreement of $65,000,000 under which there was nothing outstanding at January 3, 1981. Interest on borrowings under this agreement are at the prime rate, plus a commitment fee of ½ of 1% on the unused available credit. The company also has a line of credit totalling $10,000,000 with four domestic banks under which there was $1,500,000 outstanding at January 3, 1981. In addition the company has a $10,650,000 line of credit in Canada under which $2,130,000 was outstanding at year end.

The agreements relating to the 5.5 per cent, 8.25 per cent, 9.375 per cent, 9.25 per cent and 7 per cent notes

and the revolving credit agreement contain various restrictions, certain of which relate to the maintenance of specified consolidated working capital and the availability of retained income for the payment of cash dividends and purchase, redemption or retirement of the company's capital stock.

Under the most restrictive of these, the company must maintain consolidated domestic working capital, as defined, of not less than $75 million and at January 3, 1981 $17,536,000 (to be increased by future consolidated domestic net income as defined) of retained income is not restricted with respect to payment of cash dividends and the purchase, redemption or retirement of its capital stock.

Development authority bonds of $6,000,000 were taken in 1980 to cover the cost of a new warehouse for Hathaway in Waterville, Maine, a new plant in Checotah, Oklahoma for White Stag and extensive renovation of the Warner offices in Bridgeport, Connecticut. $195,000 were repaid in 1980 and an additional $280,000 is classified as current portion of long-term debt. At January 3, 1981, $1,003,000 of unexpended restricted proceeds were classified as non-current assets.

At January 3, 1981, the company had $15,967,000 of inventories which were used as collateral for bankers acceptances. At December 29, 1979, such inventories amounted to $20,391,000.

Note 9—Redeemable Preferred Stock:

Each share of $1.50 cumulative convertible sinking fund preferred stock is currently convertible at any time into 1.71 shares of common stock. It is redeemable at the company's option at $40 per share and is subordinated as to dividends and distribution of assets only to the $3 preferred stock. The $1.50 cumulative convertible preferred stock is subject to a sinking fund sufficient to redeem 12,189 shares annually. At year end 1980 there were 13,139 shares of $1.50 preferred stock in the treasury. Shares in treasury are carried at cost which is less than redemption value. Over the next five years it will be necessary for the company to acquire an additional 47,806 shares of $1.50 preferred stock to meet the sinking fund requirements. The maximum cost of this stock will be $1,912,240.

	$1.50 Cumulative Convertible Preferred Stock
Capital shares issued:	
December 31, 1977 and December 30, 1978	144,458
Acquisition and retirement	(12,189)
Conversion to common stock	(22)
December 29, 1979	132,247
Acquisition and retirement	(12,189)
Conversion to common stock	(55)
January 3, 1981	120,003

Note 10—Capital Stock and Capital in Excess of Stated Value:

	Preferred $3 Non-cumulative	Preferred Series A $1.10 Cumulative Convertible	Common	Capital in Excess of Stated Value
Capital shares issued:				
December 31, 1977	1,740	333,484	3,774,379	$6,639,000
Shares issued upon exercise of stock options			8,300	34,000
December 30, 1978	1,740	333,484	3,782,679	6,673,000
Shares issued upon exercise of stock options			51,337	167,000
Retirement of $1.50 convertible preferred stock				143,000
Acquisition and retirement of stock	(190)			13,000
Conversion of preferred stock		(2,799)	2,975	
Stock dividend			189,176	1,395,000
December 29, 1979	1,550	330,685	4,026,167	8,391,000
Shares issued upon exercise of stock options			14,694	52,000
Retirement of $1.50 convertible preferred stock				144,000
Conversion of preferred stock		(21,307)	22,462	(2,000)
January 3, 1981	1,550	309,378	4,063,323	$8,585,000

Shares of unissued common stock were reserved for:	January 3, 1981	December 29, 1979	December 30, 1978
Conversion of $7,500,000 of convertible debt at $19.61 per share in 1980 and 1979 and $20.88 in 1978	382,458	382,458	359,195
Conversion of $1.50 cumulative convertible sinking fund preferred stock	182,737	186,251	221,746
Conversion of Series A $1.10 cumulative convertible subordinated preferred stock	373,360	373,360	355,597
Qualified and non-qualified stock options granted (69,000 shares in 1980, 89,730 shares in 1979, 14,500 shares in 1978) at prices from $6.55 to $23.04	247,110	202,395	205,475
Options which may be granted in the future under the company's stock option plans	37,341	96,750	9,100
Possible issuance in connection with the deferred incentive compensation plan	75,000	75,000	75,000
	1,298,006	1,316,214	1,226,113

The terms, limitations, rights and preferences of the subordinated preferred stock (1,000,000 shares authorized) are set by the Board of Directors, being subordinated as to dividends and distributions of assets to the $3 preferred stock and the $1.50 convertible preferred stock. Series A of the subordinated preferred stock without par value is entitled to cumulative dividends at the rate of $1.10 per year. Each share is convertible into 1.05 shares of common stock and is entitled to $25 in liquidation. It is redeemable at the company's option at $25 per share. There remain available for future issuance 644,403 shares of subordinated preferred stock.

The company has granted options to purchase shares of its common stock to certain employees under various option plans. Options may be granted at purchase prices not less than 80% of the market value of the shares on the date of grant. Options may be granted for a period of ten years from adoption of the plan and are exercisable in full, or from time to time in part, at any time subsequent to the first anniversary of the date of grant thereof as determined by the Compensation Committee of the Board of Directors and prior to the tenth anniversary of such date of grant.

In 1978 a Stock Incentive Plan was adopted by the company. The Plan provides for the grant of options covering up to 157,500 shares of common stock of the company to key employees of the company as designated by the Compensation Committee in consideration of services to be rendered by such employees. An optionee may exercise his option (i) by purchasing the shares at the option price or (ii) as a stock appreciation right. Upon election to exercise his option as a stock appreciation right, the optionee receives the value of the difference between the then fair market value of the optioned shares and the option price in either shares of common stock or 50% in shares and 50% in cash. The Committee may disallow the exercise of a stock appreciation right at its discretion.

On May 15, 1979 a 5% common stock dividend aggregating 189,176 shares was paid to shareholders of record on April 15, 1979 of which 5,613 shares went to the treasury. Retained income was charged $2,104,583, an amount equal to $11.125 per share, the closing price on March 23, 1979, the date of declaration of the dividend. Of such amount the common stock account was credited with $709,410 equal to $3.75 per share (the stated value) and capital in excess of stated value was credited with $1,395,173 or $7.375 per share.

Note 11—Capital and Operating Leases:

The company and its subsidiaries lease buildings for periods ranging up to 20 years and transportation equipment for a three year period, pay all maintenance costs, and guarantee residual values stated in the leases. The following is an analysis of the leased property under capital leases included with property, plant and equipment:

	January 3, 1981	December 29, 1979
Buildings and building improvements	**$5,453,000**	$5,407,000
Machinery and equipment	**111,000**	111,000
	5,564,000	5,518,000
Less allowances for amortization	**2,124,000**	1,940,000
	$3,440,000	$3,578,000

Amortization of the property, plant and equipment recorded under capital leases is included with depreciation expense.

The following is a schedule by years of future minimum lease payments under capital leases together with the present value of the net minimum lease payments as of January 3, 1981.

	Capital Leases
1981	$ 674,000
1982	651,000
1983	612,000
1984	278,000
1985	203,000
Later years	1,384,000
Total minimum lease payments	3,802,000
Less:	
Executory costs	1,063,000
Amounts representing interest	707,000
Present value of net minimum lease payments	$2,032,000
Reflected as:	
Current liability	$ 285,000
Long-term liability	1,747,000
	$2,032,000

Rental expense (reduced by sub-lease rentals of $673,000—1980, $413,000—1979, $330,000—1978) included in costs and expenses was $6,893,000 for 1980, $5,776,000 in 1979 and $6,008,000 in 1978.

The following is a schedule by years of future minimum rental payments required under operating leases that have initial or remaining noncancelable lease terms in excess of one year as of January 3, 1981:

	Real Estate		Equipment	
	Rental Expense	Sub-Lease Rentals	Rental Expense	Sub-Lease Rentals
1981	$3,240,000	$493,000	$1,624,000	$376,000
1982	2,765,000	438,000	1,259,000	219,000
1983	2,432,000	382,000	905,000	—
1984	1,816,000	133,000	314,000	—
1985	1,186,000	28,000	37,000	—
1986–1990	2,116,000	109,000	3,000	—
1991–1995	288,000	—	—	—
1996–2000	3,000	—	—	—
2001–Expiration	—	—	—	—

Note 12—Contingent Liabilities:

In 1978 a subsidiary of the company, White Stag Manufacturing Co., received notice of civil penalties from the United States Customs Service totaling $101,450,000 regarding pre-1974 importing transactions. Similar claims against other companies have been resolved for a small fraction of the amounts originally assessed by Customs. A settlement proposal with respect to this matter is now under consideration by the Customs Service.

A division of the company (formerly a subsidiary) has been under investigation by the Internal Revenue Service in connection with the alleged receipt of improper shipping rebates, and subpoenas have been served on the subsidiary, its own subsidiaries and the company in a related Grand Jury investigation. These investigations could result in additional taxes and penalties assessed against the company.

In 1976 the company provided a reserve for loss contingencies which, in the opinion of management, is adequate to cover fines, penalties or losses expected to result from the foregoing matters. In anticipation of the resolution of these matters the reserve was reclassified to accrued liabilities at the end of 1979. The matters to which that reserve related are now expected to be resolved during 1981.

Note 13—Financial Reporting and Changing Prices (Unaudited):

In 1979 the Financial Accounting Standards Board issued Statement No. 33, Financial Reporting and Changing Prices, requiring enterprises to provide information about the effects that general inflation (constant dollar) and other specific price changes (current costs) have on an enterprise's financial statements.

In arriving at the net earnings amounts adjusted to 1980 constant dollars and current costs, the cost of goods sold and depreciation of fixed assets have been adjusted. Such adjustments were made based on an interpretation of the stated requirements of FAS 33 making certain assumptions. This data may not be comparable to other companies, including those within the industry, due to various methods of estimation. According to FAS 33 revenues and all expenses other than the cost of goods sold and depreciation are considered to reflect the average price levels for the year and, accordingly, have not been adjusted.

General Inflation—The purpose of the constant dollar presentation required by FAS 33 is to provide financial information in dollars of equivalent value of purchasing power (constant dollars), so that revenues for each time period are matched with expenses expressed in corresponding units. Amounts adjusted for general inflation shown in the table below were calculated accordingly. We agree with the logic of the adjustments for depreciation and net monetary gain. However, we do not believe that the adjustment required for cost of goods sold in constant dollars reflects the realities of the apparel industry. In our industry orders are typically booked several months before the goods are shipped. They are booked at selling prices that are based on cost estimates made at the time. These estimates closely approximate the actual cost of manufacturing or purchasing the goods. The selling price is set to provide an adequate profit margin based on these costs. While the FAS requirement increases the cost of goods sold by the amount of general inflation that has occurred between the time of actual manufacture or purchase and the actual shipment, it leaves the revenue part of the transaction unadjusted. The result is a profit margin substantially below the satisfactory level achieved when using actual dollars.

Specific Price Changes—The objective of the current cost method is to reflect the effects of changes in specific prices (also referred to as current costs) of the resources actually used in the company's operations, so that measures of these resources and their consumption reflect the current cost of replacing these resources, rather than the historical cost amounts actually expended to acquire them. The current year cost of goods sold was determined by applying apparel price indices to inventories. These showed a far smaller fluctuation than those related to general inflation in 1979, but approximated the general inflation increase in 1980. Land and buildings were restated generally by using current appraised or assessed values. Machinery and equipment were restated by using machinery and equipment cost indices from government publications.

The consolidated statements of income adjusted for

changing prices for the year ended January 3, 1981 are as follows:

Statement of Income
(Dollars in thousands except per share data)

	As Reported in the Primary Statements	Adjusted for General Inflation	Adjusted for Changes in Specific Prices (Current Costs)
Net sales	$465,009	$465,009	$465,009
Cost of goods sold	317,884	329,054	327,699
Depreciation and amortization expense	4,699	6,487	8,733
Other operating expense	103,344	103,344	103,344
Interest expense	14,474	14,474	14,474
Provision for income taxes	8,018	8,018	8,018
	448,419	461,377	462,268
Income from operations	$ 16,590	$ 3,632	$ 2,741
Operating income per share fully diluted	$3.42	$ .78	$ .56
Gain from decline in purchasing power of net amounts owed		$ 5,164	$ 5,164
Increase in specific prices (current cost) of inventories and property, plant and equipment held during the year*			$ 13,496
Effect of increase in general price level			19,300
Excess of increase in general prices over increase in the specific price level			$ 5,804

*At January 3, 1981 current cost of inventory was $100,890,000 and current cost of property, plant and equipment, net of accumulated depreciation was $59,878,000.

The following five-year comparison shows selected historical financial data adjusted to average 1980 dollars as measured by the required CPI-U:

Five-Year Comparison of Selected
Supplementary Financial Data Adjusted For Effects of Changing Prices
(Dollars in thousands except per share data)

	1976	1977	1978	1979	**1980**
Net sales	$569,580	$521,543	$503,277	$508,977	**$465,009**
Historical cost information adjusted for general inflation:					
Income from operations				1,392	**3,632**
Net income from operations per share fully diluted				.24	**.78**
Net assets at year end				117,610	**120,700**
Current cost information:					
Income from operations				7,068	**2,741**
Net income from operations per share fully diluted				1.52	**.56**
Excess of increase in general prices over increase in the specifc price level				2,785	**5,804**
Net assets at year end				129,244	**126,689**
Gain from decline in purchasing power of net amounts owed				6,293	**5,164**
Cash dividends declared per common share	.58	.00	.00	.40	**.80**
Market price per common share at year end	10.49	12.58	11.53	13.20	**15.50**
Average consumer price index	170.5	181.5	195.4	217.4	**246.8**

Report of Independent Accountants

To the Board of Directors and Shareholders of Warnaco Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income and retained income and of changes in financial position present fairly the financial position of Warnaco Inc. and its subsidiaries at January 3, 1981, and December 29, 1979, and the results of their operations and the changes in their financial position for each of the three years in the period ended January 3, 1981, in conformity with generally accepted accounting principles consistently applied. Our examinations of these statements were made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

Bridgeport, Connecticut
February 6, 1981

Price Waterhouse & Co.

Ten-Year Summary of Operations

(Dollars in thousands except per share data)	1980	1979
From apparel operations:		
Net sales	**$465,009**	$448,345
Cost of goods sold	**319,005**	315,790
Interest expense	**14,474**	14,579
Selling, administrative, general and other expenses	**106,587**	96,264
Income (loss) before provision for dispositions and loss contingencies, taxes and minority interest	**24,943**	21,712
Provision for sale or liquidation of certain facilities and investments and loss contingencies	**—**	—
Income (loss) before taxes and minority interest	**24,943**	21,712
Provision for taxes	**8,018**	7,457
Minority interest	**335**	332
Operating income (loss)	**16,590**	13,923
From discontinued non-apparel operations, net of taxes	**—**	—
Income (loss) before extraordinary credit	**16,590**	13,923
Extraordinary credit-tax effect of carry forward of prior years' operating losses and credits	**—**	2,641
Net income (loss)	**16,590**	16,564
Income per common share and common equivalent share:—		
Primary:		
Operating income (loss)	**$ 3.87**	$ 3.28
Income (loss) from discontinued operations	**—**	—
Income from extraordinary credit	**—**	.64
Net income (loss)	**3.87**	3.92
Assuming full dilution:		
Operating income (loss)	**$ 3.42**	$ 2.93
Income (loss) from discontinued operations	**—**	—
Income from extraordinary credit	**—**	.54
Net income (loss)	**3.42**	3.47
Dividends per common share	**$ .80**	$ .35
Current assets	**$185,049**	$182,712
Current liabilities	**68,763**	76,120
Working capital	**116,286**	106,592
Property, plant and equipment	**30,306**	26,899
Long-term debt	**43,487**	41,937
Redeemable preferred stock	**4,800**	5,290
Non-redeemable preferred stock, common stock and other shareholders' equity	**102,303**	88,838
Net income (loss) applicable to common shareholders:		
Primary	**16,228**	16,193
Fully diluted	**16,858**	16,832
High/Low		
Warnaco Common Stock	**17¾**	13
	10⅛	8¾
Standard & Poor's 500 Stock Index	**140.52**	111.27
	98.22	96.13
Standard & Poor's Apparel Stock Index	**51.38**	44.82
	39.45	29.03
Common shareholders	**4,970**	5,407
Employees	**10,045**	9,946
Average number of common and common equivalent shares	**4,196,284**	4,133,390

1978	1977	1976	1975	1974	1973	1972	1971
$398,462	$383,550	$393,490	$337,941	$324,254	$285,509	$245,956	$210,751
281,293	276,139	291,766	249,035	230,810	200,442	174,617	150,104
9,304	9,433	9,978	8,232	9,413	6,631	4,598	3,790
89,926	86,193	93,669	77,695	71,046	60,762	54,870	48,500
17,939	11,785	(1,923)	2,979	12,985	17,674	11,871	8,357
1,050	1,100	14,200	—	—	1,402	373	—
16,889	10,685	(16,123)	2,979	12,985	16,272	11,498	8,357
7,731	5,839	6,628	2,225	2,918	5,778	3,410	2,271
501	248	575	725	651	73	12	17
8,657	4,598	(23,326)	29	9,416	10,421	8,076	6,069
—	—	—	—	(3,400)	8	840	834
8,657	4,598	(23,326)	29	6,016	10,429	8,916	6,903
4,514	2,461	—	—	—	—	—	—
13,171	7,059	(23,326)	29	6,016	10,429	8,916	6,903
$ 2.00	$ 1.02	$ (5.76)	$ (.08)	$ 2.23	$ 2.50	$ 1.90	$ 1.42
—	—	—	—	(.82)	—	.20	.20
1.09	.60	—	—	—	—	—	—
3.09	1.62	(5.76)	(.08)	1.41	2.50	2.10	1.62
$ 1.83	$ 1.00	$ (5.76)	$ (.08)	$ 2.07	$ 2.36	$ 1.81	$ 1.41
—	—	—	—	(.73)	—	.18	.19
.93	.50	—	—	—	—	—	—
2.76	1.50	(5.76)	(.08)	1.34	2.36	1.99	1.60
$ .00	$ .00	$ .38	$ .76	$ .76	$ .76	$ .57	$ .57
$175,686	$152,539	$170,395	$169,477	$164,146	$154,824	$132,929	$123,497
76,276	62,595	84,256	66,173	58,957	58,154	47,122	39,706
99,410	89,944	86,139	103,304	105,189	96,670	85,807	83,791
26,801	26,760	27,895	31,748	30,679	28,361	28,811	29,012
45,837	49,900	53,901	58,636	61,576	51,720	45,504	44,556
5,778	5,778	6,266	7,241	7,729	8,216	8,616	9,167
74,123	62,130	55,135	79,611	82,994	76,130	69,805	62,579
12,799	6,682	(23,693)	(343)	5,824	10,423	8,910	6,897
13,433	7,322	(23,053)	297	6,283	10,696	9,183	6,974
13⅞	9⅞	12½	11½	11½	20⅜	24¾	20⅞
7¾	6⅜	5½	7¼	6¾	8¾	16¾	14¾
106.99	107.00	107.83	96.58	101.05	121.74	119.79	104.77
86.90	90.71	90.90	68.65	60.96	91.05	100.87	90.16
31.51	28.85	28.12	21.29	21.27	48.79	66.41	68.37
23.51	22.85	20.87	11.84	9.64	16.55	45.07	54.84
5,485	6,055	6,260	6,030	5,800	5,000	4,200	4,360
10,695	11,830	12,875	13,025	14,045	13,060	13,050	11,550
4,147,089	4,121,346	4,116,442	4,134,705	4,130,806	4,165,111	4,250,051	4,257,007

Management's Discussion and Analysis

1980 Compared to 1979

Net sales in 1980 exceeded net sales in 1979 by $16,664,000 or 4%. Specific commentary re: sales of individual divisions are included in the business segment discussions and should provide a better understanding of the company's market positions for the year 1980. It should be noted that all continuing business units except the CBS Imports Division and the Jerry Silverman dress division experienced sales gains for the year 1980. The High Tide (Junior Swimwear) division was liquidated during 1980. A license agreement was reached with another manufacturer to use the High Tide label and pay royalties to Warnaco Inc. The Hirsch Weis Camping and Watersports components were sold during 1980. Disposition of these three units resulted in lost sales of approximately $5,000,000 during the second half of 1980.

Gross profit as a percentage of net sales was 31.4% in 1980 and 29.6% in 1979. The improved margin resulted from a more favorable product mix, better utilization of operating capacity and better control over excess/obsolete inventories.

Selling, administrative and general expenses increased $10,136,000 (10.9%). The increases were widespread and are mostly attributable to inflationary influences. In some instances, expenses increased due to new product introductions where a return is not expected until 1981 and beyond.

Interest expense for 1980 remained about the same as in 1979. Despite generally higher average interest rates, borrowings were somewhat lower resulting in a slightly favorable comparison.

The provision for income taxes was 32.1% and 34.3% of income before income taxes in 1980 and 1979 respectively. The lower tax provision results from a more favorable mix of domestic and off shore income. A detailed reconciliation of the changes in tax provisions is contained in Note No. 4.

An extraordinary credit of $2,641,000 during 1979 resulted from a reduction in tax provision due to utilization of an operating loss carry forward. All such credits were fully utilized in 1979.

Net income after taxes but before extraordinary credits was 19.2% or $2,667,000 above 1979. Net income after extraordinary credit was approximately even. After-tax earnings as a percent of sales increased from 3.1% to 3.6% before extraordinary credits.

At year end 1980 order backlogs for Spring 1981 deliveries were exceptionally strong for most of Warnaco's major divisions. CBS Imports was an exception.

Total working capital at year end was $116,286,000 in 1980 and $106,592,000 in 1979. The ratio of current assets to current liabilities was 2.7 to 1.0 for 1980 and 2.4 to 1.0 for 1979. Accounts receivable balances increased faster than net sales reflecting the high interest rates prevalent during 1980 and the generally longer average collection cycle which resulted.

Total financial resources provided from all sources were $27,123,000 in 1980 and $20,752,000 in 1979. The large majority of these funds were provided from operations. These funds were primarily utilized to finance fixed asset additions, provide increased working capital as needed to support internal growth and to pay dividends.

In recent years Warnaco has attempted to control capital expenditures at levels equal or close to annual depreciation charges. During 1980, net investment in fixed assets increased $3,407,000 due to major expansion or renovation programs at Bridgeport, Connecticut (Warner's), Waterville, Maine (Hathaway) and Checotah, Oklahoma (White Stag).

1979 Compared to 1978

Fiscal year 1979 net sales increased 13% over 1978. Major increases were achieved by the Hathaway group (44%) and by White Stag (22%). Acquisition of the Destino group during 1979 which markets leather goods and jewelry under the Dior label added approximately $5,000,000 to 1979 volume. For administrative and management control purposes the Destino unit is included as part of the Hathaway group.

Gross margin as a percentage of sales increased to 29.6% in 1979 from 29.4% in 1978. The increase would have been substantially higher but for a very large increase in low gross margin sales by the company's CBS Imports division. Other product lines showed generally more favorable increases in gross margins.

Interest expense for 1979 was $14,579,000 up $5,275,000 or 57% over the 1978 figure. Near record high prime interest rates during the company's peak borrowing periods were the reason for the unfavorable interest cost variance.

Selling, general and administrative expenses increased 7% or slightly less than the inflation rate for the year. Some start up efforts on new product categories

during the year contributed to higher selling, general and administrative expenses in some areas.

The provision for income taxes in 1979 was 34.3% of income before income taxes. The comparable figure for 1978 was 45.8%. The lower rates in 1979 resulted from lower federal statutory rates plus an increase in the amount of foreign source income taxed at lower than U.S. rates, and the utilization of accumulated investment tax credits from the loss carry forward period.

Net income for the year after taxes and extraordinary credits was $16,564,000 increasing from $13,171,000 in 1978. Before extraordinary credits in both periods net income in 1979 was 3.1% of sales compared with 2.2% in 1978.

Dividend payments were resumed during the year after having been suspended for approximately three years.

Working capital at year end 1979 amounted to $106,592,000 compared with $99,410,000 at the end of 1978.

The ratio of current assets to current liabilities at the end of 1979 was 2.4 to 1.0 and was 2.3 to 1.0 at the end of 1978. Inventories and accounts receivable balances at year end increased at rates slightly below annual sales growth reflecting generally improved utilization in these current asset categories.

Short-term debt balances at year end 1979 and 1978 were $27,122,000 and $26,103,000 respectively. Long-term debt balances were reduced during the year by $3,900,000 as payments were made as scheduled.

Net Sales by Operating Groups (Millions)

	1980	1979	1978	1977	1976
Net Sales					
Women's Wear:					
Intimate Apparel	**$ 62.2**	$ 55.6	$ 54.1	$ 51.3	$ 48.8
Sportswear	**46.1**	47.4	50.8	47.2	49.2
Dresses	**7.4**	9.8	10.8	11.0	8.9
Swimwear	**4.8**	7.1	9.1	6.3	9.1
Discontinued	**—**	—	—	—	19.7
	$120.5	$119.9	$124.8	$115.8	$135.7
Men's Wear:					
Shirts	**$103.1**	$ 85.5	$ 73.5	$ 66.8	$ 65.9
Sweaters	**25.0**	19.1	18.0	17.9	12.6
Accessories	**15.0**	11.6	5.9	5.2	4.0
Importing	**55.3**	62.8	40.6	35.9	38.1
Discontinued	**—**	—	—	12.9	21.0
	$198.4	$179.0	$138.0	$138.7	$141.6
Recreation and Leisure	**$ 60.5**	$ 70.8	$ 64.2	$ 62.9	$ 55.2
Warnaco International	**$ 75.4**	$ 69.9	$ 63.7	$ 61.0	$ 62.5

Intimate Apparel

Net sales in 1980 were $62,200,000 increasing 12% over the comparable 1979 figures. The Warner's daywear unit, started in 1978, experienced strong growth from a small base and appears positioned to become an important factor in the daywear lingerie category. Warner Brand volume and Exclusive Apparel (the private brand component of the intimate apparel group) experienced continued strong growth during the period.

Bookings for this segment have been at all time record highs during the early weeks of 1981.

Sportswear

Net sales in 1980 were $46,100,000, down from $47,400,000. A strong performance by White Stag's women's sportswear unit was negated somewhat by the Rosanna unit's fashion sweater operations where sales were lower than last year. The White Stag sportswear unit completes a third consecutive recovery year of exceptional growth and is fast becoming a major factor in the moderate misses category.

Bookings for White Stag sportswear's Spring 1981 lines are very strong. Rosanna figures continue to fall

somewhat behind but are expected to recover in Fall 1981 on the strength of a resurgent market for fashion knits.

Dresses

Net sales declined to $7,400,000 from $9,800,000 as the very high-priced women's dress segment experienced sales difficulties during this period.

Shirts (Men's)

Sales increased from $85,500,000 in 1979 to $103,100,000 in 1980. This segment includes Hathaway dress and sport brands, Dior dress and sport brands, Chaps dress and sport brands, Puritan sport shirts and Thane sport shirts. All product lines experienced exceptionally stong demand and ended the year with overall record backlogs. Profits for the group were also at record highs. The current strong market position of these brands has prompted an indepth review of our position within each market sub-segment. New growth strategies are being developed as a result of these studies.

Sweaters (Men's)

Sales increased to $25.0 million up 31% over the $19.1 million reported for 1979. In a strong sweater year, Warnaco sweater brands appear to have outperformed the competition.

Profits were also at record highs as excess capacity problems which had plagued our factories for several years are now largely resolved. We are optimistic that the successes of 1980 will continue through 1981.

Accessories (Men's)

This segment, while not a major factor in total Warnaco volume, becomes increasingly important as a profit contributor. The Destino-Dior leather goods and jewelry operations finished 1980 on an exceptionally strong note and advance orders for 1981 are at record levels.

Importing

This category showed a 12% decline in volume for the year. Losses for the importing division were substantial as inventories were reduced to manageable levels. We are taking further actions as required to produce acceptable profit levels in our importing operation.

Recreation and Leisure

As noted previously, the Hirsch Weis Camping and Watersports divisions were sold during 1980 which accounts for a portion of the sales decline in this category. White Stag's action sports categories (White Stag Skiwear and Mountain Goat) had excellent performances despite a second consecutive year of disappointing snow conditions. The strong showing despite some problems at the retail level with ski lines in general indicates strong acceptance of our products and the probability of a good year for 1981.

Warnaco International

Volume increased 8% to $75,400,000 during a year of consolidating prior gains, clearing up some long term nagging difficulties and establishing a new base for growth in 1981.

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Wells Fargo Bank

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Bank and Trust Company

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New Orleans Open Golf
Tournament of the PGA Tour

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Rennett, Weiss

Compensation
Messrs. Fine, French,
Jennings, Moran

Finance
Messrs. Field, Manheim,
Oppenheimer, Warner

Public Policy
Messrs. Field, Jennings,
Kittredge, Warner

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Chief Operations Officer

Larry L. Pflieger
Senior Vice President,
Chief Financial Officer
and Treasurer

Lloyd P. Stauder
Vice President, Secretary
and General Counsel

Edward B. Dailey
Controller

Allen Finkenaur
Assistant Treasurer,
Tax Administration

Pierre A. Frye
Assistant Secretary,
Assistant General Counsel

Annual Meeting

The Annual meeting of shareholders will be held at 10:00 a.m. on Friday, April 24, 1981 at New Orleans Chamber of Commerce Building, Camp and Gravier Streets, New Orleans, Louisiana.

Shareholders of record on February 24, 1981 will be entitled to vote in person or by proxy at this meeting.

Shareholder Reports and Inquiries

Annual and interim reports are mailed directly to all shareholders of record and through banks and brokers to holders in "street" or nominee names. Shareholders in the latter categories, or any interested investor, may receive reports directly from the company by contracting Warnaco Shareholder Relations, 350 Lafayette Street, Bridgeport, Connecticut 06602, phone 203/579-8098 It is unavoidable at times that second copies of reports may be received. In such cases, we suggest that extra copies not be wasted but be passed on to interested persons.

Instructions or inquiries regarding transfers, changes of title or address, or lost certificates should be directed to the Transfer Agent, attention Warnaco Transfers. In the event of delay or problems, the company would appreciate being notified. The simplest way to do this is to forward a copy of correspondence to Warnaco Shareholder Relations.

Transfer Agent and Registrar

Hartford National Bank and
Trust Company
150 Windsor Street
Hartford, Connecticut 06115

Independent Accountants

Price Waterhouse & Co.
10 Middle Street
Park City Plaza
Bridgeport, Connecticut 06604

Executive Offices

350 Lafayette Street
Bridgeport, Connecticut 06602

Traded

New York Stock Exchange
Boston Stock Exchange
(Stock Ticker Symbol WRC)

Form 10-K

Copies of the form 10-K annual report filed with the Securities and Exchange Commission may be obtained by shareholders free of charge, by writing to Warnaco Shareholder Relations.

WARNACO

350 Lafayette Street
Bridgeport, Connecticut 06602